Monthly Economic & Finance Briefing

Economic, Banking & Industry Research of BCA Group - DKP

BI policy: Reflation scare subsides, but risks remain

Executive Summary:

- **Bank Indonesia maintained its 7-Day Reverse Repo rate at 3.50%.**
- Despite the recent calm in treasury markets, as well as its own downgrading of Indonesia's growth forecast, BI moved to hold rates steady **as the increasing divergence in economic recovery between the US and emerging markets heightens capital outflow risks from risky assets.**
- With rate policy relatively constrained, **BI is likely to focus on maintaining ample liquidity support for the government's fiscal measures.** It should also be noted that declining foreign ownership of government bonds since the pandemic began should weaken the vicious link between domestic bond yields and the exchange rate despite remaining uncertainties regarding bond yields and demand.

- **Bank Indonesia held its 7-Day Reverse Repo rate steady at 3.50%,** in line with the expectations of most analysts.

- BI made its decision against the backdrop of a month-long calm in capital markets, which had been previously roiled by rising treasury yields and fears of inflation. **Indeed, while the specter of an inflationary surge cannot be wholly ruled out, markets seem to have priced in most of the expected price increases.** The all-consuming reflation trade appears to be currently taking a breather **(*Charts 1 & 2*)**.

- Reflation's hiatus however, is not merely the relieved sigh of a market no longer quivering in fear of an overheating recovery, for this recovery itself has begun to come under siege in the past few days. The threat of Covid-19, seemingly rendered small in the past few months as mass vaccinations began and winter's viral peak flattened out, **has begun to flare up again as vaccination programs run into supply bottlenecks and caseloads begin to rise again in certain parts of the world.**

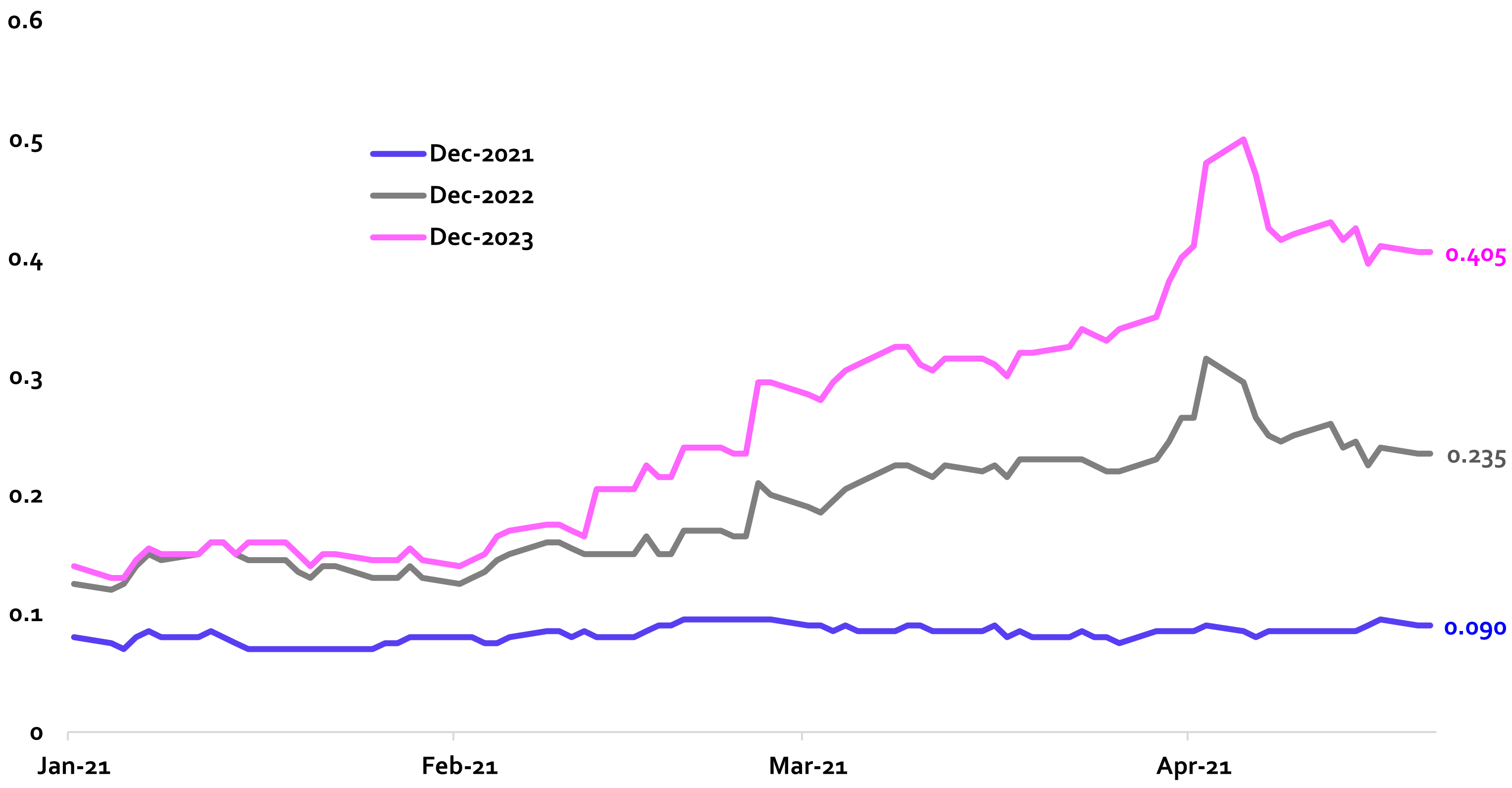
- The warning signs are at their brightest in the developing world. Countries like India and Brazil are fast becoming the new global epicenters of Covid-19, where a resurgence of the virus threatens to throw another wrench in their fragile recoveries. With certain countries such as the US and the UK pulling much ahead of the rest of the world in their vaccination drives, the contours of what might be a very uneven global recovery had already begun to take shape early in the year. The shifting of Covid's center of gravity to the developing world is but another development in that trend, **and drives home the point that the risk of divergence remains unabated, not just for the real economy, but for capital market flows as well.**

- **With all these uncertainties in mind, it is no surprise that BI decided to keep rates steady in spite of the recent calm in capital markets. This cautious stance is likely to persist going forward.** That BI decided to refrain from cutting rates even as it revised its growth forecast for Indonesia downwards from 4.3% to 4.1% reflects these persistent capital market uncertainties. Indeed, both are driven by the same factors. The government's ban on *mudik* this year, likely to take some edge off growth, was probably motivated by concerns of an India-esque resurgence in cases. The critical role played by India in manufacturing vaccines for the developing world is another vulnerability, and export bans by the Indian government have already caused delays in Indonesia's own vaccination drive.

- With these factors weighing down on growth, BI appears to have calculated – rightly so – that rates are better off playing defense, and that ensuring ample funding for fiscal measures would be its main priority in bolstering economic activity. Indeed, BI purchased around IDR 101.9 trillion worth of government bonds this month.

- This too however, faces several risks from the relative skittishness of foreign capital. If foreign capital remains wary, the government must turn to domestic savers. Should economic activity and consumer demand recover however, domestic players will also have less savings to absorb government bonds. **With so many caveats still at play, BI would need to remain waiting in the wings as a buyer of last resort.** That being said, the declining foreign ownership of domestic bonds over the past year should weaken the vicious link between the Rupiah and bond yields **(*Chart 3*)**. This should mitigate some of the risks of a sharper depreciation of the Rupiah.

Chart 1. The market has largely moderated its earlier expectations of an earlier tightening cycle by the Fed…

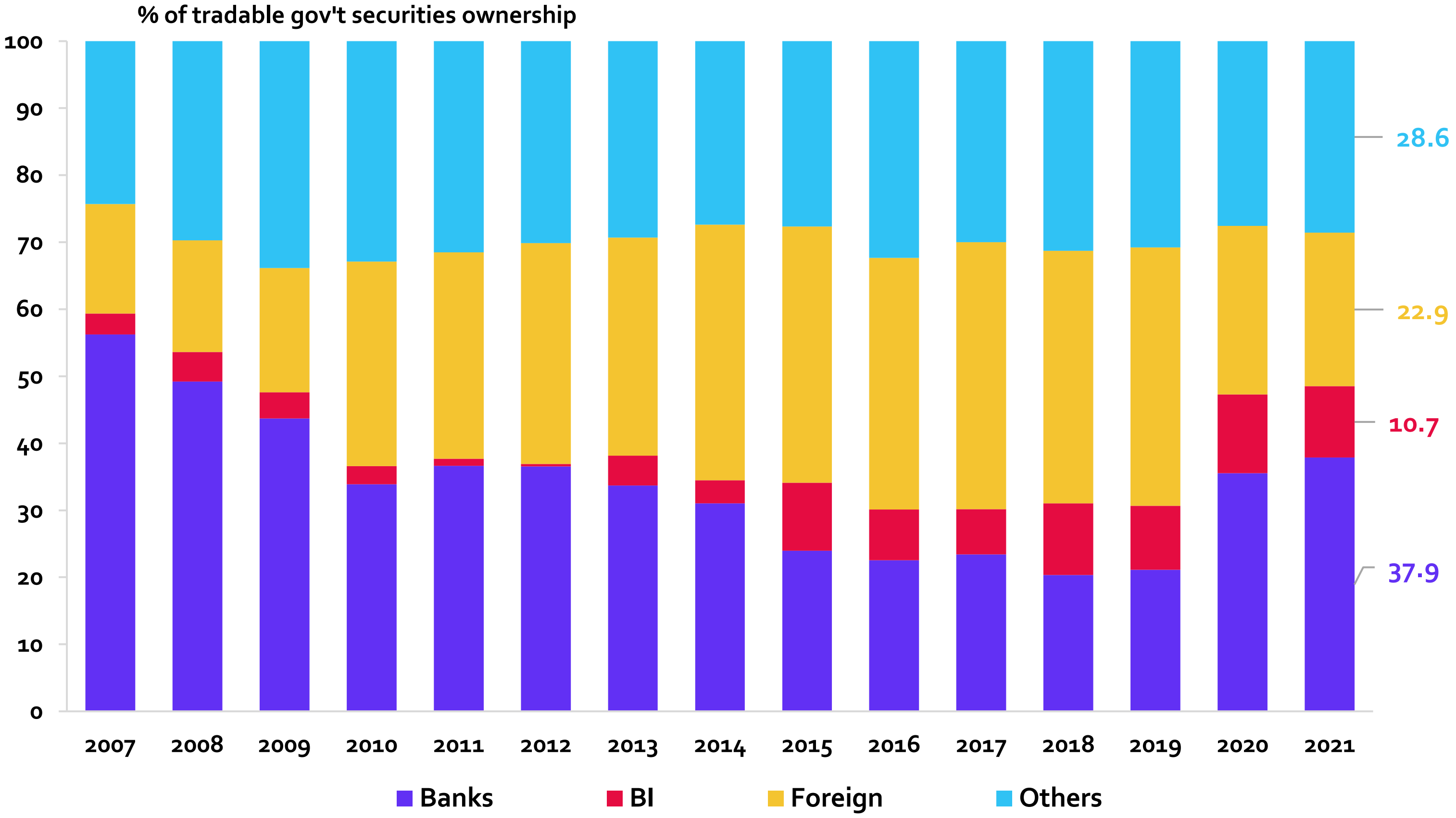


Source: Bloomberg (last update: 20 Apr 2021)

Chart 2. …as US treasury yields plateau and the "flight to USD" begins to reverse

Source: Bloomberg (last update: 20 Apr 2021)

Chart 3. Foreign ownership of Indonesian government bonds has decreased since the beginning of the pandemic



Source: Ministry of Finance

Indonesia – Economic Indicators Projection

	2016	2017	2018	2019	2020	2021E
Gross Domestic Product (% YoY)	5.0	5.1	5.2	5.0	-2.1	4.8
GDP per Capita (US$)	3605	3877	3927	4175	3912	4055
Consumer Price Index Inflation (% YoY)	3.0	3.6	3.1	2.7	1.7	3.1
BI 7 day Repo Rate (%)	4.75	4.25	6.00	5.00	3.75	3.50
USD/IDR Exchange Rate (end of year)**	13,473	13,433	14,390	13,866	14.050	14.460
Trade Balance (US$ billion)	8.8	11.8	-8.5	-3.2	21.7	10.1
Current Account Balance (% GDP)	-1.8	-1.6	-3.0	-2.7	-0.4	-1.8

** Estimation of Rupiah's fundamental exchange rate

Selected Recent Economic Indicators

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	0.25	Mar-20	-2.35
UK	0.10	Mar-20	-0.30
EU	0.00	Mar-16	-1.30
Japan	-0.10	Jan-16	0.30
China (lending)	4.35	Oct-15	3.95
Korea	0.50	May-20	-1.00
India	4.00	May-20	-1.52
Indonesia	3.50	Mar-21	2.13
Money Mkt Rates	**19-Apr**	**-1 mth**	**Chg (bps)**
SPN (1M)	2.67	2.85	-17.7
SUN (10Y)	6.42	6.78	-36.2
INDONIA (O/N, Rp)	2.79	2.79	-0.3
JIBOR 1M (Rp)	3.56	3.56	0.0
Bank Rates (Rp)	**Jan**	**Dec**	**Chg (bps)**
Lending (WC)	9.27	9.21	6.15
Deposit 1M	4.05	4.22	-17.18
Savings	0.84	0.86	-2.39
Currency/USD	**19-Apr**	**-1 mth**	**Chg (%)**
UK Pound	0.715	0.721	0.82
Euro	0.831	0.840	1.12
Japanese Yen	108.2	108.9	0.66
Chinese RMB	6.510	6.509	-0.02
Indonesia Rupiah	14,548	14,408	-0.96
Capital Mkt	**19-Apr**	**-1 mth**	**Chg (%)**
JCI	6,052.5	6,356.2	-4.78
DJIA	34,077.6	32,628.0	4.44
FTSE	7,000.1	6,708.7	4.34
Nikkei 225	29,685.4	29,792.1	-0.36
Hang Seng	29,106.2	28,990.9	0.40
Foreign portfolio ownership (Rp Tn)	**Mar**	**Feb**	**Chg (Rp Tn)**
Stock	1,878.6	1,930.8	-52.25
Govt. Bond	951.4	971.4	-20.00
Corp. Bond	28.9	28.4	0.52

Trade & Commodities	19-Apr	-1 mth	Chg (%)
Baltic Dry Index	2,432.0	2,281.0	6.6
S&P GSCI Index	490.6	475.1	3.3
Oil (Brent, $/brl)	67.1	64.5	3.9
Coal ($/MT)	90.4	88.4	2.3
Gas ($/MMBtu)	2.68	2.46	9.2
Gold ($/oz.)	1,771.4	1,745.2	1.5
Copper ($/MT)	9,384.3	9,072.5	3.4
Nickel ($/MT)	16,071.5	16,253.5	-1.1
CPO ($/MT)	1,008.4	970.3	3.9
Rubber ($/kg)	1.59	1.75	-9.1
External Sector	**Mar**	**Feb**	**Chg (%)**
Export ($ bn)	18.35	15.26	20.3
Import ($ bn)	16.79	13.27	26.6
Trade bal. ($ bn)	1.57	1.99	-21.3
Central bank reserves ($ bn)	137.1	138.8	-1.23
Prompt Indicators	**Mar**	**Feb**	**Dec**
Consumer confidence index (CCI)	93.4	85.8	96.5
Car sales (%YoY)	10.5	-38.2	-34.4
Motorcycle sales (%YoY)	N/A	-30.8	-45.1
Cement sales (%YoY)	10.9	0.7	-12.6
Manufacturing PMI	**Mar**	**Feb**	**Chg (bps)**
USA	64.7	60.8	390
Eurozone	62.5	57.9	460
Japan	52.7	51.4	130
China	50.6	50.9	-30
Korea	55.3	55.3	0
Indonesia	53.2	50.9	230

Source: Bloomberg, BI, BPS
Notes:
*Previous data
For change in currency: **Black indicates appreciation against USD, **Red** indicates depreciation
***For PMI, **> 50** indicates economic expansion, **< 50** indicates contraction

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